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SUBJECT: APACHE ENERGY EXPANDS ARGENTINE HYDROCARBON EXPLORATION AND DEVELOPMENT

REF: '06 Buenos Aires 2598

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Summary

¶1. (SBU) Apache Energy is expanding exploration and development activities in Argentina's southern most Tierra del Fuego province, with \$100 million invested in new production in 2006 and an additional \$150 million budgeted in 2007. This expansion comes despite shrinking profit margins caused by substantial increases in labor expenses driven by domestic inflation and aggressive unions; GoA-mandated below-market price caps on domestic sales of oil and natural gas; and high export tariffs on gas exports. In separate meetings with Ambassador, President Kirchner and Tierra del Fuego governor-elect Rios, Apache stressed the company's commitment to its Argentine operations. End Summary

Apache in Argentina

¶2. (U) On July 10, Ambassador met with a delegation of Apache Corporation senior management, including Raymond Plank, Founder and Chairman; Steve Farris, President and CEO; Roger Plank, VP & CFO (Raymond Plank's son); Floyd Price, VP for Eurasia and Latin America; George Lawrence, Board Member; and Robert Johnston, VP & Argentina Country Manager. Johnston had earlier hosted the Ambassador's visit to Apache facilities in Tierra del Fuego in February (Ref C). Discussion focused on the outlook for Apache's oil and gas operations in Argentina, in light of recent wage increase negotiations and constrained domestic and export oil and gas prices.

13. (U) Established in 1954, Houston-based Apache Corporation holds a diverse portfolio of U.S. domestic and international oil and gas exploration and production assets valued at \$19.3 billion. It is one of the world's largest independent oil and gas players, with sizeable investments in Egypt, Canada, the North Sea and Australia. Apache acquired its initial Argentine assets with its 2001 purchase of Fletcher Challenge and its 2002 merger with Anadarko. In April, 2006, Apache purchased Pioneer Energy's oil and gas exploration and production assets in Argentina's Neuquen, San Jorge and Austral basins for roughly \$675 million. Beyond its Pioneer acquisition, in September 2006 Apache purchased roughly \$430 million of Pan American Energy's production and exploration assets in Tierra del Fuego province's Austral Basin.

14. (SBU) Austral basin assets were particularly attractive to Apache given GoA income tax and oil/gas export tax exemptions in place to promote investment in this difficult environment. However, in October 2006, the GoA issued a "re-interpretation" of this tax exemption law which, according to Apache, not only revoked the exemption but did so retroactively. Apache claims the value of their Tierra del Fuego investments have declined by 30% as a consequence of this GoA move (Ref B).

15. (SBU) Argentina-wide, Apache currently operates 102 oil wells, 67 gas wells, and 22 water injection wells with a total daily production of 4300 barrels of oil/day, 180 million cubic ft of gas/day; and 1300 barrels of liquid petroleum gas/day. Oil production is sold to domestic refineries. 60% of gas production is sold domestically and the rest is exported to Chile. Apache employs 78 full time employees and 220 full time contract employees, all of whom belong to the petroleum union.

Apache: "Model" Investor in Challenging Environment

16. (SBU) According to Johnston, Apache has been a model corporate citizen in Argentina, investing \$100 million in new production in 2006 and expecting to invest a further \$150 million in 2007. Natural gas production from assets acquired in 2006 from Pan American have risen 20%. However, Apache says it is constrained by price ceilings imposed by the GoA on domestic sales of gas and by high GoA tariffs on hydrocarbon exports (Ref A): Apache sells its gas at an average price of about \$1 per million cubic feet (13-15% of world market prices) and faces rapidly increasing labor costs. To avoid a planned strike, Apache granted its production employees a roughly 40% bonus in December 2006. On top of this, the petroleum employees union recently negotiated a 30% wage increase with the GoA. The union has indicated that it will seek another raise following the presidential election. Apache also noted that protests by indigenous Mapuche tribe groups in Neuquen province are blocking the extraction of 5 million cubic ft/day of gas.

17. (SBU) In spite of low profit margins relative to Apache's other operations worldwide, company executives told Ambassador they are determined to press forward with ambitious development plans. These include completing over 1,800 square kilometers of new seismic testing in Tierra del Fuego, mobilizing two drilling rigs, two work over rigs and drilling up to 15 new wells more than the previous operator drilled in the past 10 years at a total cost of \$143 million. As a consequence, the size of Apache's Tierra del Fuego operations will soon equal those in the company's more mature Neuquen province fields. Apache execs contrasted their expanded recovery operations with those of Argentina's largest, vertically integrated oil and gas major, Spanish-owned Repsol-YPF. Repsol, they said, was not investing significantly in new oil and gas development and is a "poor" operator, in term of recovery efficiency. They regretted that Repsol was unwilling to "farm out" some of its less productive assets to aggressive recovery companies like Apache. They noted that current GoA interests in maintaining good relations with Spain and in having Argentine interests purchase a minority stake in Repsol (Ref D) would likely provide that company some cover for its poor performance and under investment.

Corporate Social Responsibility

¶8. (SBU) Apache execs noted their successful corporate social responsibility efforts in Egypt building over 200 one-room school houses for girls and noted that they were exploring similar initiatives here in Argentina. Ambassador offered the guidance of our Public Affairs and Commercial sections to help identify charitable endeavors that would be appreciated in Tierra del Fuego and Neuquen and bolster Apache's public profile in these provinces.

Meetings with Kirchner and Tierra del Fuego Governor Elect

¶9. (SBU) Later that day, Apache executives met with President Kirchner, Planning Minister De Vido, former Economy Minister Miceli and former Secretary of Industry (and current Economy Minister) Peirano. Kirchner praised Apache's aggressive investment strategy in Argentina. Country Manager Johnston reported that, when Apache raised its girls school project in Egypt, Kirchner responded that Apache "should find gas and the GoA will build the schools."

¶10. (SBU) That same evening, Apache met with governor-elect of Tierra del Fuego, Fabiana Rios. When Rios expressed concern at hydrocarbon company environmental management in Tierra del Fuego, Apache explained that the company had expended an additional \$10 million in a \$40 million 3D seismic testing program to import ecologically friendly "shot-hole" drillers from Canada and Texas in order to avoid surface scarring. Apache contrasted this upbeat meeting with Rios to their previous difficult interactions with

current governor Hugo Cocarro (Ref C). Before departing Argentina July 11, Apache executives held a final meeting with Central Bank Governor Redrado, who told Apache that, while Planning Minister De Vido would leave government after October elections, "his voice will still be heard."

Comment

¶12. (SBU) Apache's substantial 2006 investment in Tierra del Fuego exploration and development assets and its 2007 commitment -- despite earlier adverse tax rulings -- to further expand its operations there won Apache senior management a meeting with President Kirchner. The President's comment on Apache's social responsibility proposal ("you find the gas, we'll build the schools") was instructive: The Kirchner administration's populist rhetoric positions the government as protecting the Argentine people from private sector interests driven by profit. Embassy will continue to support U.S. investor corporate social responsibility efforts to highlight U.S. investor interests in building solid long term relationships with their Argentine host communities.

WAYNE